59 0316

28pgs

FILED
JUN 11 2007
OFFICE OF THE CLERK
SUPREME COURT, U.S.

(14)

No. 06-43

IN THE

Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC,

Petitioner,

v.

SCIENTIFIC-ATLANTA, INC. and MOTOROLA, INC.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF OF THE AMERICAN ASSOCIATION FOR JUSTICE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

LEWIS S. EIDSON
1050 31st Street, N.W.
Washington, DC 20007
(202) 965-3500
President, American Association for Justice

LOUIS M. BOGRAD
Counsel of Record
CENTER FOR CONSTITUTIONAL LITIGATION, P.C.
1050 31st Street, N.W.
Washington, DC 20007
(202) 944-2803
Counsel for Amicus Curiae

TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

IDENTITY AND INTEREST OF *AMICUS CURIAE* 1

SUMMARY OF THE ARGUMENT 1

ARGUMENT 3

I. The Language of Section 10(b) of the Securities Exchange Act and Rule 10b-5 (a) and (c), as well as the Decisions of this Court, All Justify Imposing Primary 10(b) Liability on a Party Who Engages in Deceptive Acts as Part of a Scheme to Defraud Purchasers or Sellers of Securities. 3

II. Contemporaneous Understandings of Fraud Encompassed Such Deceptive Conduct and Should Inform this Court's Construction of the 1934 Act. 10

A. Dictionary Definitions 10

B. Common Law Precedent 12

C. The Restatement of Torts 16

III. The Appropriate Test to Distinguish Primary § 10(b) Liability from Aiding and Abetting Should Focus on Whether the Defendant Itself Engaged in Deceptive or Manipulative Conduct as Part of a Fraud Scheme. 19

CONCLUSION 22

TABLE OF AUTHORITIES

Cases

A.T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967) 5

Addison v. Holly Hill Fruit Prod., Inc., 322 U.S. 607 (1944) 10

Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972) 5

Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490 (7th Cir. 1986) 21

Basic Inc. v. Levinson, 485 U.S. 224 (1988) 12

Berkowitz v. Lyons, 119 A. 20 (N.J. 1922) 14

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) 12

Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994) ..... passim

Chiarella v. United States, 445 U.S. 222 (1980) 5

Cooper v. Pickett, 137 F.3d 616 (9th Cir. 1998) 21

Crompton v. Beedle, 75 A. 331 (Vt. 1910) 15

Downey v. Finucane, 98 N.E. 391 (NY 1912) 15

Dura Pharm., Inc. v. Broudo, 544 U.S. 336 (2005) 12

Eliason v. Wilborn, 335 Ill. 352 (1929) 11

Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) ..... passim

Herman & MacLean v. Huddleston, 459 U.S. 375 (1983) 12

In re Lernout & Hauspie Sec. Litig., 236 F. Supp. 2d 161 (D. Mass. 2003) 21

In re Parmalat Sec. Litig., 376 F. Supp. 2d 472 (S.D.N.Y. 2005) 21

In re: Charter Commc'n, Inc., Sec. Litig. 443 F.3d 987 (8th Cir. 2006) 6

Laidlaw v. Organ, 15 U.S. (2 Wheat.) 178 (1817) 15

Northeastern Ry. Co. v. Wanless, (1874-75) LR 7 H.L. 12 14

Noved Realty Corp. v. A.A.P. Co., 293 N.Y.S. 336 (N.Y. 1937) 15

O'Hagan v. United States, 92 F.3d 612 (8th Cir. 1996) 6

Pennebaker v. Kimble, 269 P. 981 (1928) 14, 15

Santa Fe Indus. v. Green, 430 U.S. 462 (1977) 5

Schreiber v. Burlington Northern, Inc., 472 U.S. 1 (1985) 14

Scott v. Brown, Doering, McNab & Co., [1892] 2 Q.B. 724 (C.A.) 12, 13

SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963) 4

SEC v. Zandford, 535 U.S. 813 (2002) 5, 7, 8

Simpson v. Homestore.com, Inc., No. 04-55665 (9th Cir. Filed Oct. 22, 2004) 20

Simpson v. AOL Time Warner, Inc., 452 F.3d 1040 (9th Cir. 2006) 20, 21

Stewart v. Wyoming Cattle Ranche Co., Ltd., 128 U.S. 383 (1888) 15

Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971) 5

United States v. Brown, 5 F. Supp. 81 (S.D.N.Y. 1933) 13

United States v. O'Hagan, 521 U.S. 642 (1997) 6, 8

Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc., 532 U.S. 588 (2001) 8, 9, 16

Statutes

15 U.S.C. § 78 *et.seq.* (1934) 1

15 U.S.C. § 78j(b) ..... passim

Other Authorities

Arnold S. Jacobs, 5B *Disclosure and Remedies Under the Securities Laws* (2005) 12

Black's Law Dictionary (3d ed. 1933) 11

L. Loss & J. Seligman, *Fundamentals of Securities Regulation* (5th ed. 2004)) 12

Restatement (First) of Torts ..... passim

Restatement (Second) of Torts 16

Regulations

17 C.F.R. 240.10b-5 (Rule 10b-5) ..... passim

IDENTITY AND INTEREST OF *AMICUS CURIAE*

The American Association for Justice ("AAJ"), formerly the Association of Trial Lawyers of America, respectfully submits this brief as *amicus curiae* in support of petitioner. TThis brief is filed with consent of all parties. Petitioner's letter is on file with this Court. Respondent's letters are attached.[1]

AAJ is a voluntary national bar association whose approximately 50,000 trial lawyer members primarily represent individual plaintiffs in personal injury cases and other civil actions, including securities fraud suits. Throughout its 40-year history, the association has fought to preserve the protections for ordinary citizens afforded by the common law and to ensure that remedial legislation such as the Securities Exchange Act of 1934 is construed to provide injured persons with an effective remedy against those who have wrongfully harmed them through fraud or other misconduct.

SUMMARY OF THE ARGUMENT

1. The Court of Appeals erred in limiting the reach of § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78 *et.seq.* (1934) to actors in a scheme to defraud investors who themselves make a material

---

[1] Pursuant to Supreme Court Rule 37.6, Amicus discloses that no counsel for a party authored any part of this brief, nor did any person or entity other than Amicus Curiae, its members, or its counsel make a monetary contribution to its preparation.

misstatement or omission or commit a manipulative act. This conclusion was based on a misreading of this Court's decision in *Central Bank of Denver v. First Interstate Bank of Denver,* 511 U.S. 164 (1994). The language of § 10(b) and of the Securities and Exchange Commission's implementing rule 10b-5(a) and (c), 17 C.F.R. 240.10b-5 (Rule 10b-5) is not so limited. The decisions of this Court—including *Central Bank* itself and subsequent rulings—make clear that these provisions reach deceptive acts perpetrated by secondary actors in furtherance of a scheme to defraud.

2. Contemporaneous understandings of fraud support this reading of § 10(b). Dictionary definitions, common law precedents, and the first Restatement of Torts all demonstrate that at the time the Exchange Act was drafted the concept of fraud encompassed deceptive conduct. The Restatement also confirms that liability for fraudulent misrepresentation extended to actors whose deceptive conduct, indirectly communicated to another, was intended to influence the other's conduct in a transaction with a third person.

3. The proper test for distinguishing primary § 10(b) liability from aiding and abetting should focus on whether a defendant personally engaged in deceptive or manipulative actions in furtherance of a fraudulent scheme. Under such a test, Petitioner has alleged satisfactorily that both Scientific-Atlanta, Inc., and Motorola, Inc., have committed violations of that section and Rule 10b-5(a) and (c).

ARGUMENT

I. The Language of Section 10(b) of the Securities Exchange Act and Rule 10b-5 (a) and (c), as well as the Decisions of this Court, All Justify Imposing Primary 10(b) Liability on a Party Who Engages in Deceptive Acts as Part of a Scheme to Defraud Purchasers or Sellers of Securities.

Contrary to the conclusion of the Court of Appeals below, neither § 10(b) of the Securities Exchange Act nor Rule 10b-5, the Securities Exchange Commission (SEC) rule implementing that section, is limited to material misstatements and omissions (and manipulative acts), thereby excluding deceptive conduct from their reach. Section 10(b) states, in pertinent part:

> It shall be unlawful for any person, *directly or indirectly*, . . . (b) *[t]o use or employ*, in connection with the purchase or sale of any security . . . , *any* manipulative or *deceptive device or contrivance* in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (emphases added). Rule 10b-5, in turn, provides in relevant part:

> It shall be unlawful for any person, directly or indirectly, . . . (a) [t]o employ

> any device, scheme, or artifice to defraud, . . . or (c) [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. 240.10b-5(a) and (c).[2]

Both the statute and rule are broad enough, on their face, to reach deceptions by deed as well as by word. They cover, expressly, deceptive "devices," "contrivances," "schemes [and] artifices to defraud," and "acts, practices, [and] courses of business" which operate as a fraud or deceit, by "any person," both "direct [and] indirect." This Court has repeatedly instructed that the statutory text must be the starting point for interpretation. *See, e.g., Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976). So the Court's inquiry could end right here.

But there is much more. The "fundamental purpose" of the 1934 act and its companion enactments was "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963). Therefore, both before and after *Central Bank*, this Court has instructed that section 10(b) and related securities legislation "enacted for the purpose of avoiding frauds" must "be construed 'not technically and restrictively, but flexibly to effectuate

---

[2] Rule 10b-5(b), by contrast, does require an express "untrue statement" or omission of a material fact.

its remedial purposes.'" *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972) (quoting *Capital Gains Research Bureau*, 375 U.S. at 195); *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971); *SEC v. Zandford*, 535 U.S. 813, 819 (2002).

Time and time again this Court has announced that § 10(b) was intended to bar securities fraud in all of its various guises. *See, e.g., Santa Fe Indus. v. Green*, 430 U.S. 462, 476 (1977) ("the statute provides a cause of action for any plaintiff who 'suffer(s) an injury as a result of deceptive practices touching its sale (or purchase) of securities.'") (quoting *Superintendent of Ins.*, 404 U.S. at 12-13; *Affiliated Ute*, 406 U.S. at 151 ("These proscriptions, by statute and rule, are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive."); *Superintendent of Ins.*, 404 U.S. at 11 n.7 ("'We believe that § 10(b) and Rule 10b-5 prohibit all fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud or present a unique form of deception. Novel and atypical methods should not provide immunity from the securities laws.'") (quoting *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967); *Ernst & Ernst*, 425 U.S. at 203 (Section 10(b) "was described rightly as a 'catchall' clause to enable the Commission 'to deal with new manipulative (or cunning) devices.'").[3]

Despite this unambiguous guidance from this Court, the court below latched onto some loosely

---

[3] *Cf. Chiarella v. United States*, 445 U.S. 222, 234-35 (1980) ("Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud.").

written language from *Central Bank* to conclude – erroneously – that § 10(b) liability does not extend to any defendant "who does not make or affirmatively cause to be made a fraudulent misstatement or omission," regardless of whether that defendant engaged in deceptive acts as part of a scheme to defraud. *In re: Charter Commc'n, Inc., Sec. Litig.* 443 F.3d 987, 992 (8th Cir. 2006).[4] The Court of Appeals quoted a passage from *Central Bank* that read: "As in earlier cases considering conduct prohibited by § 10(b), we again conclude that the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act," *id.* at 990 (quoting 511 U.S. at 177), and incorrectly took it to mean that "[a] device or contrivance is not 'deceptive,' within the meaning of § 10(b) absent some misstatement or failure to disclose by one who has a duty to disclose." *Id.* at 992.

---

[4] This would not be the first time that the Eighth Circuit took a sentence from *Central Bank* out of context and read too much into it. In *O'Hagan v. United States*, 92 F.3d 612, 619 (8th Cir. 1996), the Eighth Circuit "isolated the statement" from *Central Bank* that "[a]ny person or entity . . . who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5. . ." and "drew from it the conclusion that § 10(b) covers only deceptive statements or omissions on which purchasers or sellers, and perhaps other market participants, rely." *United States v. O'Hagan*, 521 U.S. 642, 664 (1997). This Court, reversing, explained: "It is evident from the question presented in *Central Bank*, however, that this Court, in the quoted passage, sought only to clarify that secondary actors, although not subject to aiding and abetting liability, remain subject to primary liability under § 10(b) and Rule 10b-5 for certain conduct." *Id.*

It should have been clear from context that the passage quoted from *Central Bank* used the phrase "material misstatement (or omission)" simply as shorthand for deceptive conduct, in order to distinguish persons who engage in such conduct from those who merely aid and abet, the issue before the Court.[5] Elsewhere in the opinion this Court could not have been more explicit: "In §10(b), Congress *prohibited* manipulative or *deceptive acts* in connection with the purchase or sale of securities." 511 U.S. at 173 (emphasis added).[6]

Moreover, any possible ambiguity left by *Central Bank* about § 10(b)'s application to deceptive conduct has been resolved by subsequent rulings of this Court. In *SEC v. Zandford* 535 U.S. 813 (2002), this Court held unanimously that a securities broker's alleged conduct of selling his clients' securities with the undisclosed intent to misappropriate the proceeds constituted fraud

---

[5] Indeed, as Petitioner observed in its Petition for Certiorari, the quoted passage in *Central Bank* was supported by citations to prior caselaw that referred more broadly to "manipulation and deception" and immediately followed by two sentences that linked the scope of § 10(b) to "manipulative or deceptive acts." Pet. for Cert. at 15-16 (quoting 511 U.S. at 177-78). Because respondents in *Central Bank* had conceded that the bank "did not commit a manipulative or deceptive act within the meaning of § 10(b)," *id.* at 191, it was not necessary for the Court in that case to precisely define those terms.

[6] *See also id.* at 177-78 ("We cannot amend the statute to create liability for *acts* that are not themselves manipulative or deceptive within the meaning of the statute.") (emphasis added).

under § 10(b).[7] The Court emphasized that it was the broker's acts, not his words, which violated the act: "Indeed, each time respondent 'exercised his power of disposition for his own benefit,' that conduct, 'without more,' was a fraud. In the aggregate, the sales are properly viewed as a 'course of business' that operated as a fraud or deceit on a stockbroker's customer." *Id.* at 821.[8]

This Court was even more explicit that a violation of § 10(b), and of Rule 10b-5(a) and (c),[9] does not require a material misstatement or omission in *Wharf (Holdings) Ltd. v. United Inernational Holdings, Inc.*, 532 U.S. 588 (2001). In *Wharf*, this Court held, again unanimously, that a company that sold an option to purchase stock in a cable television system with the secret intent not to honor that option violated Rule 10b-5. In the course of the opinion, the Court stated that Rule 10b-5 forbids the use of "four kinds of manipulative or deceptive devices": "(1) 'any device,

---

[7] The central issue in *Zandford* was whether the broker's conduct satisfied the "in connection with the purchase or sale of any security" requirement of § 10(b). No one questioned whether his fraudulent scheme constituted a "deceptive device or contrivance" under the act.

[8] Elsewhere in the opinion this Court expressly disclaimed that a violation of § 10(b) required a "misrepresentation": "neither the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of the Act." *Id.* at 820.

[9] This Court has determined that the "scope of Rule 10b-5 is coextensive with the coverage of § 10(b). *See SEC v. Zandford*, 535 U.S. at 816 n.1; *U.S. v. O'Hagan*, 521 U.S. at 651; *Ernst & Ernst*, 425 U.S. at 185.

scheme, or artifice to defraud'; (2) 'any untrue statement of a material fact'; (3) the omission of 'a material fact necessary in order to make the statements made . . . not misleading'; or (4) any other 'act, practice, or course of business' that 'operates . . . as a fraud or deceit." *Id.* at 593 (2000).[10] The Court then explained that "[t]o succeed in a Rule 10b-5 suit, a private plaintiff must show that the defendant used, in connection with the purchase or sale of a security, *one* of the four kinds of manipulative or deceptive devices to which the Rule refers . . ." *Id.* (emphasis added). That is to say, a plaintiff can prevail on a 10b-5 claim by proving a violation of Rule 10b-5(a) or (c) (the first and fourth kinds of deceptive devices identified by the Court), without demonstrating any material misstatement or omission (the second and third kinds).

Thus, the language of § 10(b) and Rule 10b-5, as well as the decisions of this Court, both before and after *Central Bank,* make it unlawful for any person, in connection with a securities transaction, to engage in deceptive conduct in furtherance of a scheme to defraud. As will be seen in the next section, this construction of § 10(b) is also entirely consistent with the understanding of fraud at common law and at the time of the enactment of the Exchange Act.

---

[10] This division of Rule 10b-5 obviously tracks its three subparts, with section 10b-5(b) divided in two in order to distinguish material misstatements from material omissions.

II. Contemporaneous Understandings of Fraud Encompassed Such Deceptive Conduct and Should Inform this Court's Construction of the 1934 Act.

In an attempt to discern Congress's meaning when it enacted the Exchange Act—and to flesh out the terms of the private right of action implied under § 10(b)—courts often look to contemporaneous sources that may provide insight into the meaning of statutory terms. At least three sets of sources from around the time of enactment—dictionaries, common law precedent, and the first Restatement of Torts—each provide a broad understanding of actionable fraud that lends support to Petitioner's claims in this case.

A. Dictionary Definitions

In *Ernst & Ernst,* this Court turned to contemporaneous dictionaries in order to determine the "commonly accepted meaning" of the "operative language" of § 10(b).[11] 425 U.S. at 199:

> Webster's International Dictionary (2d ed. 1934) defines "device" as "(t)hat which is devised, or formed by design; a contrivance; an invention; project;

---

[11] The Court explained its focus on commonly accepted meaning with a quotation from *Addison v. Holly Hill Fruit Prod., Inc.*, 322 U.S. 607, 617-18 (1944): "After all, legislation when not expressed in technical terms is addressed to the common run of men and is therefore to be understood according to the sense of the thing, as the ordinary man has a right to rely on ordinary words addressed to him." *Ernst & Ernst,* 425 U.S. at 199 n.19.

> scheme; often, a scheme to deceive; a stratagem; an artifice," and "contrivance" in pertinent part as "(a) thing contrived or used in contriving; a scheme, plan or artifice." In turn, "contrive" in pertinent part is defined as "(t)o devise; to plan; to plot ... (t)o fabricate . . . design; invent . . . to scheme . . . "

Id., n.20. The Court cited these definitions to support a scienter requirement for § 10(b) liability, but they also support an expansive reading of the kinds of "device or contrivance" covered by the statute.

Other dictionaries from the same era provide equally broad definitions of "fraud" and "deception." *See Black's Law Dictionary* 529 (3d ed. 1933) (defining "deception" as "[t]he act of deceiving; intentional misleading by falsehood spoken or acted."); *Eliason v. Wilborn*, 335 Ill. 352, 357 (1929) ("The *Century Dictionary* defines fraud as 'an act or course of deception deliberately practiced with the view of gaining a wrong or unfair advantage; deceit; trick; an artifice by which the right or interest of another is injured.'"); *id.* at 358 ("1 Bouv. Law Dict. p. 1304, states that active and positive fraud includes cases of the intentional and successful employment of any cunning, deception, or artifice to circumvent, cheat, or deceive another."). These definitions not only track much of the language that ultimately found its way into Rule 10b-5, they also clearly establish the contemporaneous understanding that fraud could be accomplished by acts as well as words.

B. Common Law Precedent

Similarly, this Court and lower courts have looked to the common law for guidance about how to construe § 10(b). Private securities fraud actions judicially implied under this section have "common-law roots", *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 344 (2005), and "resemble in many (but not all) respects common-law deceit and misrepresentation actions." *Id.* at 343 (citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 744 (1975), and L. Loss & J. Seligman, *Fundamentals of Securities Regulation* 910-18 (5th ed. 2004)). Although actions under § 10(b) are "distinct from" common-law causes of action, *Basic Inc. v. Levinson*, 485 U.S. 224, 244 n.22 (1988). Indeed, the statutory cause of action is generally understood to be substantively broader and to provide more protection to investors than the common law. *Id.* (citing *Herman & MacLean v. Huddleston*, 459 U.S. 375, 388-89 (1983); *see generally* Arnold S. Jacobs, 5B *Disclosure and Remedies Under the Securities Laws* § 6:50 (2005).

There can be no doubt that the common law recognized, and made actionable, fraud by deceptive conduct. In the seminal English case of *Scott v. Brown, Doering, McNab & Co.*, [1892] 2 Q.B. 724 (C.A.), the court held unlawful an agreement among the parties to purchase shares in a company in order to induce others who might thereafter consider investing to believe, falsely, that there was a *bona fide* market for the shares: "an agreement to cheat the public by leading them to believe the shares had a value, which the plaintiffs and defendants knew they had not, and thus inducing them to become purchasers. Is such a transaction illegal? I am of opinion that it is, and might be made the subject

of an indictment for conspiracy." *Id.* at 730 (Lopes, L.J.). To Lord Lopes it was irrelevant that the deception had been carried out by deeds, rather than words: "I can see no substantial distinction between false rumours and false and fictitious acts; the price of the shares in this case was artificial, and the premium unreal and nominal, to the knowledge of all parties concerned, put forward to induce the public to take shares, with which otherwise they would have had nothing to do." *Id.* at 730-31.[12]

Scott was followed in a federal mail fraud case, *United States v. Brown*, 5 F. Supp. 81 (S.D.N.Y. 1933, the year before the Exchange Act was enacted. *Brown* involved a pooling scheme to artificially raise the price of the stock of a company listed on the stock exchange. Overruling the defendants' demurrer to their indictment, the court explained, in language that could be directly applied to this case: "It is obvious that, when two or more persons, by a joint effort, raise the price of a listed stock artificially, they are creating a kind of price mirage which may lure an outsider into the market to his damage. . . . [S]uch a procedure would of itself constitute a fraud on the public." *Id.* at 93 (citing *Scott*). *See also Schreiber v. Burlington Northern,*

---

[12] *See also* the opinion of Lord Lindley, who found the fraud unlawful even though the purchase transactions were real: "The plaintiff's purchase was an actual purchase, not a sham purchase; that is true, but it is also true that the sole object of the purchase was to cheat and mislead the public." *Id.* at 728. *A fortiori*, sham transactions designed to mislead the public, such as those the Respondents are alleged to have entered with Charter Communications, would constitute fraud.

Inc., 472 U.S. 1, 7 n.4 (1985) (favorably citing *Scott* and *Brown* in federal securities litigation).

A second line of common-law decisions derives the principle that fraud can be effected by conduct from a statement attributed to the Lord Chancellor (Lord Cairns) in the House of Lords: "If one conducts himself in a particular way, with the object of fraudulently inducing another to believe in the existence of a certain state of things, and to act upon the basis of its existence, and damage resulted there from to the party misled, he who misled him will be just as liable as if he had misrepresented the facts in express terms." *See Pennebaker v. Kimble*, 269 P. 981, 984 (1928); *Berkowitz v. Lyons*, 119 A. 20, 22 (N.J. 1922).[13] *Berkowitz*, which involved the fraudulent sale of a stolen automobile, goes on to say that "want of ownership and actual misrepresentations of fact are not the sole basis of actionable fraud, since the deceit and fraud practiced can as well effectuate its baneful purpose by conduct as it can by words." 119 A. at 21. To the same effect, *see Pennebaker*, 269 P.2d at 984 ("To communicate a representation, it is not necessary that the party should speak words or write a message. The desired result may be accomplished oft times by conduct."). And the

---

[13] Both cases attribute this quotation to the case of *Northeastern Ry. Co. v. Wanless*, (1874-75) LR 7 H.L. 12, but it does not appear therein. Both cases also cite the following general description of deceit: "It may consist in the creation of a false impression by words or acts, or by any trick or device, a deep laid scheme of swindling, or a direct falsehood, a combined effort of a number of associates or the sole effort of a solitary individual." *Id.* (citing "12 R.C.L. 232").

Oregon Supreme Court describes the principles of law involved as "old and well established." *Id.* at 983.[14]

---

[14] There is yet a third line of common-law cases that may be relevant, those having to do with the doctrine of "negative deceit," which holds—even in the absence of fiduciary obligations or material misrepresentations—that "in some circumstances the suppression of a truth may be equivalent to the assertion of a falsehood." *Crompton v. Beedle*, 75 A. 331, 333 (Vt. 1910); *see also Noved Realty Corp. v. A.A.P. Co.*, 293 N.Y.S. 336 (N.Y. 1937); *Downey v. Finucane*, 98 N.E. 391 (N.Y. 1912); *Stewart v. Wyoming Cattle Ranche Co., Ltd.*, 128 U.S. 383 (1888). These cases trace back to Chief Justice Marshall's decision for this Court in *Laidlaw v. Organ*, 15 U.S. (2 Wheat.) 178 (1817), in which it was held that it was a question for the jury whether a vendee's failure to disclose to a vendor the existence of our nation's peace treaty with England (which was likely to have a significant effect on the value of the goods to be purchased) was an improper "imposition." As this Court later explained in *Stewart:*

> [M]ere silence is quite different from concealment. *Aliud est tacere, aliud celare,*-a suppression of the truth may amount to a suggestion of falsehood....The gist of the action [of deceit] is fraudulently producing a false impression upon the mind of the other party; and, if this result is accomplished, it is unimportant whether the means of accomplishing it are words or acts of the defendant, or his concealment or suppression of material facts not equally within the knowledge or reach of the plaintiff.

128 U.S. at 388. In this case, the disclosure of the respondents purchase of advertising from Charter, while suppressing the fact that Charter had itself paid for that advertising through fraudulently inflated contracts for set-

It is thus indisputable that the common law recognized a cause of action for fraud by deceptive conduct, even in the absence of any material misrepresentations.

C. The Restatement of Torts

Finallywe turn to the Restatement of Torts. This Court has often resorted to the Restatement for guidance regarding the "judicial consensus" about the meaning of the common law. *See, e.g., Dura Pharm., Inc. v. Broudo,* 544 U.S. at 343-44 (citing Restatement (Second) of Torts §§ 525, 548A); *Wharf (Holdings) Ltd.,* 532 U.S. at 596 (citing Restatement (Second) of Torts § 530). In construing the 1934 Exchange Act, it seems particularly appropriate to look to the first Restatement, which was itself a product of the 1930s, and thus reflects the judicial consensus at the time Congress enacted § 10(b).

Provisions of the first Restatement support a construction of § 10(b) that reaches the alleged conduct of Scientific-Atlanta and Motorola. To begin with, § 525 of the Restatement is explicit that the tort of fraudulent misrepresentation may be committed by conduct as well as words. Comment *b* to that section states, in relevant part: "*Misrepresentation defined.* 'Misrepresentation' is used in this Chapter to denote not only words spoken or written but also any other *conduct* which amounts to an assertion not in

---

top boxes, would seem to constitute just such a deceit through concealment.

accordance with the truth." Restatement (First) of Torts § 525 Comment *b* (1938) (emphasis added).

Section 533 of the Restatement, and the comments thereto, go further and make clear that the tort may be committed, even though the defendant has no direct communication with the person defrauded and no economic interest in the transaction influenced by the fraud. Section 533 states:

> § 533. Representation Made Through A Third Person. The maker of a fraudulent misrepresentation in a business transaction is subject to liability to another who acts in justifiable reliance upon it if the misrepresentation, although not made directly to the other, is made to a third person for the purpose of having him repeat its terms or communicate its substance to the other in order to influence his conduct in a particular transaction or type of transaction.

Restatement (First) of Torts § 533. Comment *a* to this section addresses its applicability to transactions in which the maker has no interest:

> *a. Inducing action between third persons.* The rule stated in this Section is applicable not only where the maker's purpose is to influence by its repetition the conduct of another in a transaction with the maker but also where his purpose is to influence the

> other's conduct in a transaction with a third person.

Id., Comment *a*. Further, as Comment *e* explains, the defendant need not even know the person to whom the fraud will be repeated, so long as that person is a member of the class it intends to influence through its fraudulent conduct:

> *e. Repetition to unidentified person.* While the maker of the representation is liable only if it is repeated to a person to whom it is his purpose to have it repeated or to whom its repetition is authorized, it is not necessary that he have any particular person in mind. It is enough that his purpose is to have it repeated to a particular class of persons and that the person relying upon it is one of that class.

Id., Comment *e*.

Thus, whether one looks to dictionaries of the time, common law precedent, or the Restatement of Torts, there can be no doubt that, at the time the Exchange Act was enacted, the contemporaneous understanding of fraud, deceit and misrepresentation was quite broad, and would have imposed tort liability for conduct comparable to that in which Respondents are alleged to have engaged. Congress legislated against that legal backdrop and therefore should be understood to have used similar legal terminology and concepts in an equally sweeping way.

III. The Appropriate Test to Distinguish Primary § 10(b) Liability from Aiding and Abetting Should Focus on Whether the Defendant Itself Engaged in Deceptive or Manipulative Conduct as Part of a Fraud Scheme.

The question then becomes: what test to employ in order to identify conduct by secondary actors that gives rise to liability under § 10(b)? As amicus hopes the foregoing discussion illustrates, the proper test cannot be one—like the test adopted by the Court of Appeals below—that arbitrarily distinguishes between different categories of fraudulent or deceptive behavior, holding some liable for federal securities fraud while allowing others to get off scott free. At the same time, in order to be consistent with *Central Bank*, the test must distinguish between primary liability under § 10(b) and mere aiding and abetting.

The answer, it seems to amicus, comes from the guidance provided by this Court at the conclusion of its *Central Bank* opinion: "In any complex securities fraud . . . there are likely to be multiple violators"; "[a]ny person or entity" involved in such a fraud scheme "may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met." 511 U.S. at 191.

The key requirement under § 10(b) and Rule 10b-5, and the one that most dramatically distinguishes conduct in violation of those provisions from aiding and abetting, is—in the language of the statute—the "use or employ[ment of] . . . any manipulative or deceptive device or contrivance." Defendants in 10b-5 actions who themselves engaged in manipulative or

deceptive conduct – in the broad meaning of those terms intended by Congress, articulated by this Court, and supported by the act's common-law antecedents – should be held to account for their actions.

Not surprisingly, given that it derives from this Court's guidance in *Central Bank*, this proposed test focused on the deceptive nature of the defendants' own conduct is quite similar to tests for §10(b) liability suggested by other actors and courts. In *Simpson v. AOL Time Warner, Inc.*, 452 F.3d 1040 (9th Cir. 2006), a factually similar case decided last year by the Court of Appeals for the Ninth Circuit, the SEC had proposed the following test:

> Any person who directly or indirectly engages in a manipulative or deceptive act as part of a scheme to defraud can be a primary violator of Section 10(b) and Rule 10b-5; any person who provides assistance to other participants in a scheme but does not himself engage in a manipulative or deceptive act can only be an aider and abettor.

Brief of the SEC, *Amicus Curiae*, in Support of Positions that Favor Appellant, *Simpson v. Homestore.com, Inc.*, No. 04-55665 (9th Cir. Filed Oct. 22, 2004), at 16. When the Ninth Circuit ultimately rendered its decision in the case it adopted a similar, though somewhat narrower, standard: "to be liable as a primary violator of § 10(b) for participation in a 'scheme to defraud,' the defendant must have engaged in conduct that had the principal purpose and effect of creating a false

appearance of fact in furtherance of the scheme." 452 F.3d at 1048.[15]

Other courts have employed similar language to similar effect. *See, e.g., In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp. 2d 161, 173 (D. Mass. 2003) ("better reading of § 10(b) and Rule 10b-5 is that they impose primary liability on any person who substantially participates in a manipulative or deceptive scheme by directly or indirectly employing a manipulative or deceptive device (like the creation or financing of a sham entity) intended to mislead investors, even if a material misstatement by another person creates the nexus between the scheme and the securities market"); *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 503 (S.D.N.Y. 2005) (adopting *Lernout & Hauspie* test without the "substantial participation" requirement). Indeed, as this Court noted in *Central Bank*, even before that decision "the Seventh Circuit ha[d] held that the defendant must have committed a manipulative or deceptive act to be liable under § 10(b), a requirement that in effect forecloses liability on those who do no more than aid or abet a 10b-5 violation." 511 U.S. at 170 (citing *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495 (7th Cir. 1986)).

Under any of these similar but variously-phrased tests, Petitioner has adequately alleged a §

---

[15] *See also* that court's earlier ruling, *Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1998) ("*Central Bank* does not preclude liability based on allegations that a group of defendants acted together to violate the securities laws, as long as each defendant committed a manipulative or deceptive act in furtherance of the scheme.").

10(b) violation by each Respondent. Petitioner alleges that both Scientific-Atlanta and Motorola entered into sham transactions with Charter Communications in which they agreed to "purchase" advertising from Charter with funds that Charter would funnel to them through increased payments for set-top cable boxes in excess of existing contract terms. In furtherance of this scheme, Petitioner alleges that Scientific-Atlanta created a fraudulent document to justify the price increase and that both Respondents backdated contract documents to conceal the sham nature of the transactions. Moreover, Petitioner alleges that the Respondents understood that the purpose of this scheme was to allow Charter to falsely report higher revenue and operating cash flow in its public financial statements. Pet. for Cert. at 3-7. There can be no doubt that Petitioner has alleged satisfactorily that both Scientific-Atlanta and Motorola have employed deceptive devices or contrivances in connection with securities transactions in contravention of Rule 10b-5(a) and (c). Petitioner should now be given an opportunity to prove these allegations in court.

CONCLUSION

For the foregoing reasons, Amicus urges this Court to reverse the decision of the Eighth Circuit and remand for further proceedings.

Respectfully submitted,

LOUIS M. BOGRAD
Counsel of Record
CENTER FOR CONSITUTIONAL
LITIGATION, P.C.

1050 31st Street, N.W.
Washington, DC 20007

June 11, 2007 *Counsel for Amicus Curiae*